UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

LAURA SEIDL, individually, derivatively and on behalf of all others similarly situated,

Plaintiff,

vs.

AMERICAN CENTURY COMPANIES, INC., AMERICAN CENTURY INVESTMENT MANAGEMENT, INC., JAMES E. STOWERS, JR., JAMES E. STOWERS, III, JONATHAN S. THOMAS, THOMAS A. BROWN, ANDREA C. HALL, DONALD H. PRATT, GALE A. SAYERS, M. JEANNINE STRANDJORD, TIMOTHY S. WEBSTER, WILLIAM M. LYONS, MARK MALLON, WADE SLOME, BRUCE WIMBERLY and JERRY SULLIVAN,

Defendants.

and

AMERICAN CENTURY MUTUAL FUNDS, INC., doing business as AMERICAN CENTURY ULTRA FUND,

Nominal Defendant.

INDEX No. 08-CV-8857 (DLC)
ECF Case

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Pursuant to Fed R. Civ. P. 12(b)(6), Defendants American Century Companies, Inc. ("ACC"), American Century Investment Management, Inc. ("ACIM"), James E. Stowers, Jr., James E. Stowers, III, Jonathan S. Thomas, William M. Lyons, Mark Mallon, Wade Slome, Bruce Wimberly, and Jerry Sullivan (together, "Institutional Defendants"), respectfully request that the Court dismiss Plaintiff's Second Amended Verified Derivative and Class Action Complaint ("Second Amended Complaint" or "SAC") with prejudice.

Preliminary Statement

Despite being nearly twice as long, Plaintiff's Second Amended Complaint fares no better than her earlier complaints or those filed in similar actions across the country by Plaintiff's attorneys. The expanded allegations do nothing to change the fact that Plaintiff has failed to show that the alleged losses suffered by the American Century Ultra Fund (the "Fund") were proximately caused by Defendants' decision to invest in the stock of PartyGaming plc ("PartyGaming"). Instead, as this Court has held in a related (and indistinguishable) case, the alleged losses were proximately caused by a government crackdown on online gambling and not by Defendants' actions.

Plaintiff brings this action under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961 et seq. (2000) and state common law based on otherwise typical shareholder complaints about stock price declines. Plaintiff alleges that at some time in 2006, share prices in overseas gambling companies declined because of stepped-up U.S. government enforcement efforts and that, as a result, the Fund and its shareholders suffered a loss. Plaintiff complains that Defendants' simple and unadorned act of buying shares in a publicly-traded overseas gambling company, which it held as one of many stock holdings in a mutual fund investment portfolio (a fund in which Plaintiff claims to have invested), resulted in monetary loss to Plaintiff.

With the Second Circuit's recent affirmation of the Court's decision in *McBrearty v. The Vanguard Group, Inc.*, No. 08-cv-7650, 2009 WL 875220 (S.D.N.Y. April 2, 2009) (Cote, J.), *aff'd* 2009 WL 4019799 (Nov. 23, 2009), Plaintiff's RICO claims should be dismissed based on this Court's earlier Order dismissing such claims and Plaintiff's agreement that those claims are governed by the *Vanguard* decision and the appeal to the Second Circuit in that case. Furthermore, in terms of Plaintiff's RICO allegations and theories of liability, *Vanguard* is indistinguishable from the instant case and should be dismissed under the *Vanguard* precedent.

Plaintiff's common law claims fair no better for a number of independent reasons. First, Plaintiff only has derivative—not direct—claims, and Plaintiff has made no allegation of demand on the board and only bare-bones (and deficient) allegations of demand futility. Second, as with her RICO claims, Plaintiff has not—and cannot—plead sufficient proximate causation. While the RICO proximate causation standard is in some respects more stringent than the common law standard, the same reasoning applies: any loss by Plaintiff was suffered not as a result of Defendants' investment, but as a result of the increased government enforcement efforts. Third, Plaintiff has failed to adequately plead breach of duty, since she has not pled that the investment was too risky in light of the Fund's overall holdings and objectives. Finally, Plaintiff's corporate waste allegations are wholly insufficient, as Plaintiff has not (and cannot) plead that the Fund received no consideration in exchange for its purchase of PartyGaming stock.

Thus, all that can be said of Plaintiff's allegations regarding Defendants' behavior is that one or more of the Defendants made a decision to invest mutual fund money in publicly-traded shares of a company that was being touted on Wall Street as a good investment, albeit one with risks attached. Plaintiff is not entitled to compensation just because this one investment out of the Fund's total holdings allegedly lost money when one of the risks materialized. A finding to the contrary would subject every officer, director and investment advisor to liability for any potential risk to any investment that happens to occur.[1]

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[1] In addition to the arguments herein, Defendants also join the Fund and Independent Directors' motion in all respects and incorporate their arguments fully by reference. *See* Fund and Independent Directors' Memorandum of Law in Support of their Motion to Dismiss Plaintiff's Amended Derivative and Class Action Complaint ("Fund and Ind. Directors' Mot.").

Fact Allegations

ACC (a Maryland corporation) is an investment company that is alleged to control the Fund (also a Maryland corporation), through its subsidiary ACIM (a Delaware corporation). (SAC ¶¶ 27-29.) The Fund offers a series of shares representing interests in the Fund. (*Id.* ¶ 24.) Plaintiff alleges that she is a shareholder in the Fund. (*Id.* ¶¶ 129-130.) The individual defendants were the directors, officers and portfolio managers of ACIM and ACMF. (*Id.* ¶ 31-33, 39-41.)

Plaintiff alleges that at various times, in or about June and July 2005, Defendants caused the Fund to purchase millions of shares of an "illegal gambling business" called PartyGaming. (*Id.* ¶¶ 51-60.) Plaintiff alleges that by causing the Fund to purchase stock in an illegal gambling business, Defendants caused the Fund to finance and to become an "owner" of part of an illegal gambling business in violation of 18 U.S.C. § 1955. (*Id.* ¶ 15.) Plaintiff further alleges that on June 1, 2006, a US grand jury indicted a different Internet gambling business, London based BetOnSports Plc, for racketeering, mail fraud, and running an illegal gambling enterprise. (*Id.* ¶ 86.) Plaintiff further alleges that after the public disclosure of the BetOnSports indictment, PartyGaming's share price began to fall. (*Id.* ¶ 87.) According to Plaintiff, in addition to the BetOnSports indictment, other government enforcement actions were taken, including the introduction and passage (in late-September 2006) of the Unlawful Internet Gambling Enforcement Act of 2006. (*Id.* ¶ 68.) Plaintiff alleges that by October 2006, PartyGaming's share price had dropped roughly 80%, which was due to the new government enforcement actions. (*Id.* ¶¶ 88-89.) Plaintiff does not allege any other material cause for the drop in PartyGaming's share price other than PartyGaming's anticipated loss of allegedly illegal US-based gambling revenue caused by the government enforcement efforts. (*Id.* ¶ 92.) Plaintiff alleges that on or after July 16, 2006, but prior to July 31, 2006, the Fund sold all of its shares of PartyGaming, realizing millions of dollars in losses. (*Id.* ¶ 90.)

Argument

I. LEGAL STANDARD

Under Federal Rule of Civil Procedure 12(b)(6) motion for failure to state a claim:, the court must "accept as true all factual statements alleged in the complaint and draw all reasonable inferences in favor of the non-moving party." *McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 191 (2d Cir. 2007). Furthermore, "[c]onclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to defeat a motion to dismiss." *Achtman v. Kirby, McInerney & Squire, LLP*, 464 F.3d 328, 337 (2d Cir. 2006) (citation omitted). As the Supreme Court has recently stated, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (citation omitted).

II. PLAINTIFF'S RICO CLAIMS SHOULD BE DISMISSED FOR LACK OF PROXIMATE CAUSE

A. The Second Circuit's Affirmation of the Court's Decision in *McBrearty v. The Vanguard Group* Procedurally Ends Plaintiff's RICO Claims Herein

As this Court has already ordered, Plaintiff's RICO claims must be dismissed for lack of proximate causation, a result that Plaintiff has agreed should obtain. This Court has already once dismissed Plaintiff's RICO claims (*see* Order dated 4/28/09) and Plaintiff has already agreed—both during an April 28, 2009 telephonic conference before the Court and in their Second Amended Complaint (*see* SAC ¶¶ 139-40)—that the Court's decision in *Vanguard* controls Plaintiff's RICO claims and that it is asserting such claims only to preserve them pending the then-outstanding appeal to the Second Circuit. Since the Second Circuit has now affirmed the Court's decision in *Vanguard*, the Court should dismiss Plaintiff's RICO claims—this time with prejudice—for failure to state a claim.

B. Plaintiff's RICO Claims Are Indistinguishable from *Vanguard* and Should Thus be Dismissed

Even if Plaintiff's RICO claims have not been procedurally terminated by the *Vanguard* affirmation, they are indistinguishable from the claims at issue in *Vanguard* and should thus be dismissed for failure to state a claim. A plaintiff has standing to bring a claim under RICO only if he or she has been "injured in his business or property *by reason of* a violation of section 1962 of this chapter." 18 U.S.C. § 1964(c) (emphasis added); *Denney v. Deutsche Bank AG*, 443 F.3d 253, 266 (2d Cir. 2006) ("A RICO plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the RICO violation") (internal quotations omitted). "But-for" causation is not sufficient; a plaintiff must also show that her alleged injuries were proximately caused by the alleged racketeering activity. *Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 23 (2d Cir. 1990). In assessing RICO proximate causation, "the central question [a court] must ask is whether the alleged violation led directly to the plaintiff's injuries." *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 461 (2006).

Plaintiff here cannot establish proximate cause. Plaintiff's allegations in this case are factually identical to those at issue in this Court's decision in *Vanguard* (and therefore legally indistinguishable on this motion), which has recently been affirmed by the Second Circuit, as well as the Central District of California's recent decision in *Wodka v. Causeway Capital Management LLC*, Case No. CV09-02625 R (C.D. Cal. Oct. 8, 2009).[2] As a comparison between the Second Amended Complaint herein and the *Vanguard* and *Wodka* complaints shows, there is no meaningful factual distinction between the two cases, and the Court should simply follow the precedent those decisions provide.

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[2] A copy of the complaint in the *Vanguard* case is attached as **Exhibit A** to the Declaration of Gordon C. Atkinson in Support of Institutional Defendants' Motion to Dismiss ("Atkinson Decl."), a copy of the complaint in the *Wodka* case is attached as **Exhibit B** to the Atkinson Decl., and a copy of the Order of Dismissal in *Wodka* is attached as **Exhibit C** to the Atkinson Decl. The Institutional Defendants respectfully request that the Court take judicial notice of the contents of the documents under Federal Rule of Evidence 201(b)(2) as facts "not subject to reasonable dispute" because they are "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." *See Mangiafico v. Blumenthal*, 471 F.3d 391, 398 (2d Cir. 2006) (trial court can take judicial notice of docket sheets as public records).

In the *Vanguard* case, the Court found that "[p]roximate causation is lacking . . . because the shareholders were injured not by the ownership of or investment in the illegal gambling operations, but by the reaction of the stock price to the publicity following the government's investigation of those operations." 2009 WL 875220 at *3. Quoting from the Second Circuit's decision in *In re American Express Co. Shareholder Litigation*, 39 F.3d 395, 400 (2d Cir. 1994), the Court found that "'[t]he commission of the RICO violations was not what injured plaintiffs,'" but rather, "as they acknowledge, 'it was the exposure of those acts,' through the government's investigation, as illegal that 'caused the plaintiffs' harm.'" 2009 WL 875220 at *3.

In the *Wodka* case, plaintiff alleged "injur[y] when the government began enforcement actions against other internet gaming companies and Congress passed legislation prohibiting the processing of payments for internet gambling, [which] caus[ed] the market prices of the securities held by [defendant mutual fund] to decline." (Atkinson Decl., Ex. C, at 2.) Like the complaint in this case, the *Wodka* complaint alleged that Causeway Capital had purchased shares of PartyGaming stock and the risks were known and foreseeable, including through the information concerning potential illegality and prosecution contained in PartyGaming's prospectus. (*See* Atkinson Decl., Ex. B, at ¶¶ 39-46.) Nonetheless, the court found that "Plaintiff has not sufficiently pleaded a private RICO cause of action under the facts alleged in this case for the reasons stated in [*Vanguard*]." (Atkinson Decl., Ex. C, at 2.)

Like the *Vanguard* and *Wodka* cases, Plaintiff has not shown (and cannot show) proximate causation here. Plaintiff's allegations of loss are that "[f]ollowing an increase in law enforcement actions directed against illegal off-shore gambling businesses in the summer of 2006, the Fund lost millions of dollars . . . ." (SAC ¶¶ 1, 88-89.) These allegations are indistinguishable from the *Vanguard* and *Wodka* complaints. (*See, e.g.*, Atkinson Decl., Ex. A, at ¶¶ 1, 51; Atkinson Decl., Ex. B, at ¶¶ 1, 56.) As the Court stressed in *Vanguard*, "[p]roximate causation . . . does not exist where the plaintiff's injury was 'indirectly (and hence not proximately) caused by the racketeering activity'" *Vanguard*, 2009 WL 875220 at * 2 (citing *Baisch v. Gallina*, 346 F.3d 366, 373 (2d Cir. 2003)). Plaintiff's alleged loss was caused not by

Defendants' alleged racketeering activity (investing in gambling enterprises), but by the government's investigation of off-shore gambling companies.[3] The public disclosure of the government investigation caused the alleged loss and thus there is no causal link sufficient to constitute proximate cause.

Plaintiff also fails to establish proximate cause because her allegations make it clear that she was not the target or victim of the alleged RICO violation, but a beneficiary. In applying the RICO proximate cause analysis, the Second Circuit has "repeatedly emphasized that the reasonably foreseeable victims of RICO violation are the targets, competitors and intended victims of the racketeering enterprise." *Lerner v. Fleet Bank, N.A.*, 318 F.3d 113, 124 (2d Cir. 2003). Here, the alleged racketeering activity is the investment in "illegal gambling businesses." But those who operate, control, direct, or own illegal gambling operations are expected *beneficiaries*, not victims of the alleged predicate acts, because their shares in the Fund would increase in value if the gambling business were successful. *See Vanguard*, 2009 WL 875220 at *3 (citing *American Express*, 39 F.3d at 400 n.3). As this Court held in *Vanguard*, "Plaintiffs, as those providing economic backing for the gambling investments, were not the intended victims or targets of this enterprise." *Id.* Again, applying *Vanguard* to the factually indistinguishable case at hand, Plaintiff cannot establish proximate causation or standing.

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[3] Plaintiff's Second Amended Complaint is replete with allegations concerning other aspects of the "government's increased enforcement actions," such as the introduction and passage of the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA") in late-September 2006 (*see* SAC ¶¶ 67-68; H.R. Rep. No. 109-711 (Sept. 29, 2006). And Plaintiff alleges that, following the passage of the UIGEA, PartyGaming's stock price dropped 80%. (SAC ¶ 89.) Since Plaintiff alleges that the Fund sold all of its PartyGaming shares by July 31, 2006 (*see* SAC ¶ 90), these later enforcement efforts and the losses attributed to them are irrelevant to the proximate causation issue.

III. GROUNDS FOR DISMISSAL OF COMMON LAW CLAIMS

A. Plaintiff's Direct Claims Should Be Dismissed Because any Alleged Injury Is Derivative, Not Direct

Plaintiff's direct state law claims should be dismissed because any such claims are derivative in nature. Under both Maryland[4] and Delaware law,[5] whether a claim is direct or derivative depends "solely on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004) (emphasis in original). If the harm is to the corporation and the recovery would go to the corporation, the claim is derivative. *Id.* To pursue a direct action, plaintiffs must demonstrate that shareholders suffered an injury "'independent of any injury to the corporation." *Id.* at 1038, 1036 (holding that to bring direct action, plaintiff must be able to "prevail without showing an injury to the corporation") (citations omitted).

With respect to the first prong of *Tooley*, Plaintiff alleges direct injury only to the Fund: a decline in the Fund's value caused by a decline in value of its investments in gambling companies.[6] Shareholders are allegedly harmed only by virtue of and in proportion to their ownership share. Because Plaintiff cannot prevail *without* showing an injury to the Fund, the injury is not "independent of any alleged injury to the corporation" and the claims are therefore derivative. *Tooley*, 845 A.2d at 1039.

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[4] Under the internal affairs doctrine, Maryland law applies because ACMF is a Maryland corporation (SAC ¶ 23). As a federal court sitting in diversity, this Court applies the choice-of-law rules of New York. *See Wall v. CSX Transp., Inc.* 471 F.3d 410, 416 (2d Cir. 2006). New York applies the "internal affairs" rule, which requires the Court to apply the law of the state of incorporation to any issues relating to corporate governance. *See Hausman v. Buckley*, 299 F.2d 696, 702 (2d Cir. 1962). Plaintiff's claims for negligence, breach of fiduciary duty, and waste against directors and officers of a corporation all require plaintiff to show that such directors and officers breached their duties of care and fiduciary duties to the corporation and its shareholders and mismanaged corporate assets, which duties are at the heart of a corporation's internal affairs. *See In re BP PLC Derivative Litig.*, 507 F. Supp. 2d 302, 307-09 (S.D.N.Y. 2007) (applying law of country of incorporation to breach of fiduciary duty and corporate waste claims); *Walton v. Morgan Stanley & Co. Inc.*, 623 F.2d 796, 798 n.3 (2d Cir. 1980) (applying law of state of incorporation to breach of fiduciary duty claim).

[5] Although Maryland courts have yet to articulate clearly what test should be applied to determine whether a shareholder claim is direct or derivative, Maryland courts have looked to Delaware law, including *Tooley*, as instructive. *See, e.g.*, *Jolly Roger Fund LP v. Sizeler Prop. Investors, Inc.*, No. Civ. RDB 05-841, 2005 WL 2989343 at *4 (D. Md. Nov. 3, 2005).

[6] Although Plaintiff pleads "special injuries not suffered by shareholders in ACMF who were not investors in the Fund" (SAC ¶ 246), the use of such special injury allegations as a tool to circumvent demand futility is frowned upon by the courts and does not convert a derivative

Courts uniformly reach this conclusion where, as here, the injury alleged is a decrease in the value of shares held by shareholder-plaintiffs: "courts have long recognized that actions charging '[m]ismanagement which depress[es] the value of stock [allege] a wrong to the corporation; i.e., the stockholders collectively, to be enforced by a derivative action." *Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348, 353 (Del. 1988) (citing *Bokat v. Getty Oil Co.*, 262 A.2d 246, 249 (Del. 1970)). For example, in *Hogan v. Baker*, No. Civ. A. 305CV0073P, 2005 WL 1949476, at *4 (N.D. Tex. Aug. 12, 2005), investors directly sued the advisors of seventy Delaware mutual funds on the theory that plaintiffs were injured directly because mutual funds "immediately" pass all gains and losses on to investors. The court soundly rejected this argument because "if the only injury to an investor is the indirect harm which consists of the diminution in the value of his or her shares, the suit must be derivative." *Id.*

Furthermore, Plaintiff here concedes that all of the Fund's shareholders "were injured . . . in exactly the same way" as a result of their investment. (SAC ¶ 189(c).) That concession is dispositive. The "fact that an injury to the corporation tends to diminish each share of stock equally because corporate assets or their value are diminished" indicates an "indirect injury," not "independent or direct harm to the stockholders, individually." *Tooley*, 845 A.2d at 1037.

The claims here also fail the second prong of the *Tooley* test, which asks "who would receive the benefit of any recovery or other remedy." 845 A.2d at 1033. Any recovery or relief here would properly flow to the Fund and not to the Fund's shareholders directly. This conclusion is consistent with the analysis under *Tooley's* first prong because, under that analysis, the alleged misconduct is a wrong to the Fund. *See Kramer*, 546 A.2d at 353. The alleged

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claim into a direct one. *See Tooley*, 845 A.2d at 1035 (disapproving of "the use of the concept of 'special injury' as a tool in [the direct/derivative] analysis"); *In re Evergreen Mut. Funds Fee Litig.*, 423 F. Supp. 2d 249, 261 (S.D.N.Y. 2006) (holding that allegations of paying improper distribution and management fees do not transform a derivative claim into a direct claim).

misconduct therefore "never resulted in an event or transaction that could have injured the stockholders directly, rather than indirectly as a result of their ownership of . . . shares," and "any monetary recovery . . . would properly belong to the corporation [here, the Fund], rather than to the stockholders personally." *Dieterich v. Harrer*, 857 A.2d 1017, 1028 (Del. Ch. 2004).

Finally, the fact that ACMF is a "series" fund and that the alleged harm was thus suffered only by the Ultra Fund's shareholders and not by the shareholders of the other 17 series funds (*see* SAC ¶ 192) does not transform Plaintiff's claim from a derivative claim to a direct claim as Plaintiff alleges. *See Mutchka v. Harris*, 373 F. Supp. 2d 1021, 1027-28 (C.D. Cal. 2005) (finding distinction between separate corporation and a series mutual fund is of no consequence in the determination of whether claims should be brought directly or derivatively). This is so for several reasons. First, "the SEC . . . has expressly pronounced that [for series mutual funds] each series is to be treated as a separate investment company." *See In re Mutual Funds Inv. Litig.*, 519 F. Supp. 2d 580, 588 (D. Md. 2007) (citations omitted). Second, any recovery would go to the Ultra Fund and not to the shareholders of other ACMF funds. *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS ("MD Corp. Code") § 2-208.2 (the assets and liabilities of each series are to be kept separate from the assets and liabilities of other series and of the corporation generally). Third, even if the Ultra Fund shareholders did suffer a different harm *vis-à-vis* the remaining ACMF shareholders, the test under Maryland law is whether Plaintiff's injury is distinct from the injury *to the corporation* (ACMF), not distinct from injury *to other shareholders*. Courts define a "distinct" injury as "an injury that does not derive from corporate injury." *See Struogo v. Bassini*, 282 F.3d 162, 172 (2d Cir. 2002). Plaintiff has failed to plead this distinction and instead alleges that as a result of the Institutional Defendants' allegedly negligent decision to invest in PartyGaming, she suffered a loss in share value. This is precisely the type of injury suffered by the corporation and that must be pursued as a derivative suit. *See e.g., Kramer*, 546 A.2d at 353 ("[W]here a plaintiff shareholder claims that the value of his stock will deteriorate and that the value of his proportionate share of the stock will be decreased as a result of alleged director mismanagement, his cause of action is derivative in nature") (citations omitted). Thus, the corporate structure of ACMF and its funds does not change the analysis of whether the claims are direct or derivative, and Plaintiff's arguments to the contrary would make every claim by a shareholder of a series mutual fund a direct claim no matter what the basis for the claim may be.

B. Plaintiff's Derivative Claims Should Be Dismissed Because She Fails Sufficient to Plead Demand Futility

Under both Maryland law and Federal Rule of Civil Procedure 23.1, a complaint in a derivative action must "allege with particularity the efforts, if any, made by plaintiff" to make a demand on the entity for whom it wishes to sue. *Werbowsky v. Collomb*, 766 A.2d 123, 134 (Md. Ct. App. 2001) (citing Fed. R. Civ. Proc. 23.1); *see also Aronson v. Lewis*, 473 A.2d 805, 808 (Del. 1984). The purpose of the demand requirement is to afford directors an opportunity to exercise their reasonable business judgment and "waive a legal right vested in the corporation in the belief that its best interests will be promoted by not insisting on such right." *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96 (1991) (citation omitted). Only when demand is excused as futile can a shareholder initiate suit on behalf of the corporation. *Id.* Maryland regards demand futility as a:

> very limited exception, to be applied only when the allegations or evidence clearly demonstrate, in a very particular manner, either that (1) a demand, or a delay in awaiting a response to a demand, would cause irreparable harm to the corporation, or (2) a majority of the directors are so personally and directly conflicted or committed to the decision in dispute that they cannot reasonably be expected to respond to a demand in good faith and within the ambit of the business judgment rule.

Werbowsky, 766 A.2d at 144 (articulating Maryland's common law demand futility standard).

Plaintiff's allegations of demand futility fail the stringent Maryland test.[7]

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[7] They would also fail the less stringent Delaware test, which focuses on whether (1) the directors were disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. *Aronson*, 473 A.2d at 814.

1. Plaintiff Fails to Establish that Demand Would Cause Irreparable Harm

The first prong of the Maryland test for demand futility asks whether "demand, or a delay in awaiting a response to a demand, would cause irreparable harm to the corporation." *Werbowsky*, 766 A.2d at 144. As the Fund and Independent Directors argue in greater detail (which argument the Institutional Defendants fully and specifically incorporate by reference herein), Plaintiff's allegations do not satisfy this prong, since (a) Plaintiff has not alleged why money damages would prove inadequate or difficult to ascertain, (b) Plaintiff has relied on allegations regarding irrelevant post-filing events, and (c) Plaintiff's allegation of harm from a bolstered statute of limitations defense is spurious. (Fund and Ind. Directors' Mot. at 19-20.)

2. Plaintiff Fails to Show that the Directors Would be Conflicted

The second prong of the Maryland test focuses on whether "a majority of the directors are so personally and directly conflicted or committed to the decision in dispute that they cannot reasonably be expected to respond to a demand in good faith and within the ambit of the business judgment rule." *Werbowsky*, 766 A.2d at 144. Plaintiff alleges that (a) a majority of the directors has a disabling interest because they are exposed to a substantial likelihood of criminal and civil liability (SAC ¶¶ 158-68); (b) the entire board of directors has an inherent conflict in determining whether to make a demand against other Defendants because each director has fiduciary duties to the investors in the Fund as well as to the investors in the other funds that constitute ACMF (SAC ¶¶ 170-85); and (c) that post-complaint actions show that the directors have already made up their minds (SAC ¶¶ 146-48).

a. Demand is Not Excused Because of Potential Exposure to Civil and Criminal Liability

In addition to the fact that Plaintiff has not alleged any instance of another mutual fund director, officer or advisor having faced criminal or civil liability (apart from the civil lawsuits Plaintiff's attorneys have instigated across the country),[8] even if there were some reason to

[8] It has been four years since the original investments at issue were made, and three years since the grand jury indictments were handed down against the companies in which the Fund invested. Yet Plaintiff has made no allegations concerning any prosecutions or civil lawsuits filed (other

believe that the directors face personal civil or criminal liability, demand would not be excused by such allegations. Under Delaware law,[9] Plaintiff's allegations that the Defendants face criminal and civil liability do not make out a disabling self-interest. *See Aronson*, 473 A.2d at 818 (noting that plaintiff's argument that "demand is excused because the directors otherwise would have to sue themselves" is a "bootstrap argument [that] has been made to and dismissed by other courts. Its acceptance would effectively abrogate Rule 23.1 and weaken the managerial power of directors . . . . [A] bare claim of this sort raises no legally cognizable issue under Delaware corporate law.") (citations omitted). For example, in *Seminaris v. Landa*, 662 A.2d 1350, 1355 (Del. Ch. 1995), the Delaware Chancery Court considered allegations that directors were interested because of a "threat of liability in . . . related federal lawsuits" and a "threat of criminal sanctions by the SEC." The court held that such allegations do not establish interestedness because "the threat of liability in the related actions" does not have "a greater impact on the directors' discretion than the threat of liability in [the] derivative action." *Id.* Rather, allegations of potential liability in related actions are simply "a slightly altered version of the discredited refrain—'you can't expect directors to sue themselves.'" *Id.* (citation omitted).

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than this and similar actions brought by Plaintiff's attorneys) or any known governmental investigations or inquiries commenced against any of the Defendants (or against any mutual fund companies or their directors, officers or advisors) based on such investments. Indeed, there have been no such prosecutions, lawsuits or governmental investigations. Furthermore, out of the various lawsuits that Plaintiff's attorneys have filed across the nation, none has successfully overcome motions to dismiss, and two have been dismissed with prejudice. One of the cases has now been affirmed by the Second Circuit and—as the Fund and Independent Directors note (Fund and Ind. Directors' Mot. at 15)—Plaintiff has stated that the Second Circuit's decision will have a "significant impact" on the issue of demand futility due to potential criminal/civil liability. In other words, the threat of liability here is simply trivial to non-existent and cannot even arguably form the basis of a proper demand futility allegation.

[9] Maryland courts have recognized that the demand futility standards articulated in *Werbowsky* are relatively recent and, as a result, there are few Maryland cases applying it. Consequently, Maryland courts look to Delaware law for guidance because the Delaware standard is more permissive and will excuse demand where Maryland would not. *See, e.g.*, *Sekuk Global Enters. Profit Sharing Plan v. Kevenides, et al.*, Nos. 24-C-03-007496, 24-C-03-007876, and 24-C-03-008010, 2004 WL 1982508 (Md. Cir. Ct. 2004); *see also Scalisi v. Fund Asset Mgmt., L.P.*, 380 F.3d 133, 140 (2d Cir. 2004) (noting that Maryland law characterizes the futility exception as "a narrow one"). In other words, if demand futility allegations fail to meet the looser Delaware standards, those allegations would most certainly fail the stricter Maryland standards.

Moreover, even where—unlike here—collateral actions have actually been filed, courts have still rejected assertions that potential liability in such actions renders a director interested. *See*, e.*g., In re NYFIX, Inc. Derivative Litig.*, 567 F. Supp. 2d 306, 315 (D. Conn. 2008) (potential liability in parallel state court action insufficient to establish interestedness); *Rattner v. Bidzos*, No. Civ. A. 19700, 2003 WL 22284323, at *14 (Del. Ch. Sept. 30, 2003) (potential liability in securities class action lawsuits insufficient to establish interestedness). Thus, Plaintiff's allegations concerning potential civil and criminal liability are not only implausible and unsupported, they would not support demand futility even if plausible.

b. Demand is Not Excused Because of the Directors' Fiduciary Duties to Other Funds

Demand is similarly not excused based on the directors' fiduciary duties to other funds. Plaintiff alleges that if she prevails in this litigation, "ACIM would be liable to forfeit an amount equal to three times all of the fees it has received on account of its management of the Fund's portfolio from the time that Defendants first caused ACMF to purchase shares in illegal gambling businesses. In that event, ACIM would be unable to continue covering the operational expenses of the other 17 funds that compose ACMF." (SAC ¶ 180.) But this allegation has no bearing on the Plaintiff's common law, non-RICO claims, since this prong of Plaintiff's demand futility argument rests solely on Defendants' potential liability and treble damages under RICO. *See* 18 U.S.C. § 1964(c) (permitting recovery of threefold damages in civil RICO claims). As discussed above, Plaintiff has admitted that its RICO claims should now be dismissed for failure to state a claim. Because Plaintiff cannot maintain a RICO claim against Defendants, she certainly cannot rest her demand futility allegations on an alleged conflict of interest that arises solely out of that claim.

c. Demand Futility Cannot be Shown Based on the Post-Complaint Refusal to Act

Finally, Plaintiff alleges that the directors' Answers and Motions for Judgment on the Pleadings earlier in this litigation "establish that the Directors are wholly committed to the position that Plaintiffs' claims are entirely without merit and should not be pursued on behalf of

ACMF." (SAC ¶ 146.) But the fact that corporate defendants or their directors have chosen to answer or move to dismiss in response to a derivative suit does not render demand futile. *Lewis v. Graves*, 701 F.2d 245, 250 (2d. Cir. 1983) (holding that an answer or a motion to dismiss is insufficient to show demand futility). Instead, under Federal Rule of Civil Procedure 23.1, "the futility of making the demand required . . . must be gauged at the time the derivative action is commenced, not afterward with the benefit of hindsight." *Id.* (citations omitted) Similarly, under Delaware law, "a court must determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, *as of the time the complaint is filed*, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993) (italics added). A finding to the contrary would allow any derivative plaintiff to show demand futility where he or she has an opportunity to amend after an answer or motion to dismiss.

C. Even if Demand Futility Were Properly Pled, Plaintiff's Derivative Claims Must Still be Dismissed as Substantively Insufficient

1. Maryland Law Does Not Recognize an Independent Breach of Fiduciary Duty Claim

As an initial matter, Maryland does not recognize a standalone claim for breach of fiduciary duty. *See Vinogradova v. Suntrust Bank, Inc.*, 875 A.2d 222, 230-231 (Md. Ct. Spec. App. 2005) ("Maryland does not recognize a separate tort action for breach of fiduciary duty.") Accordingly, Plaintiff's breach of fiduciary duty claim is at best a restatement of her negligence claim.

2. Plaintiff Fails to Plead Sufficient Proximate Cause (Breach of Fiduciary Duty, Negligence and Waste)

To establish causation for Plaintiff's state law claims, Plaintiff must establish (i) cause-in-fact ("factual causation"); and (ii) legally cognizable cause ("legal causation" or "proximate causation"). *See Peterson v. Underwood*, 264 A.2d 851, 855 (Md. Ct. App. 1970). **Factual causation** focuses upon whether the defendant's conduct was an actual cause of the plaintiff's alleged damages, and courts generally apply a "but-for" test, which looks at whether "an injury might not have occurred 'but-for' an antecedent act of the defendant." *Id.* **Legal (or proximate) causation**, on the other hand, requires a continuous chain of causation between defendant's alleged breach and plaintiff's alleged damages. *See Collins v. Luper*, 277 A.2d 445, 448 (Md. Ct. Spec. App. 1971) (defendant's negligent act must "continuously extend through every event, fact, act, and occurrence related to the tortious conduct of the defendant and [be] itself the logical and natural cause of the plaintiff's injury"). Thus, proximate cause does not exist where a new and independent act breaks the causal connection between the original tortious conduct and the injury. *See Sindler v. Litman*, 887 A.2d 97, 115 (Md. Ct. Spec. App. 2005) ("The chain of causation may be broken by an intervening force (negligent or non-negligent) that may, in turn, become a superseding cause, in which case the original tortfeasor's liability will terminate.").

Since both common law and civil RICO claims require a showing that a defendant's acts have a directly injured plaintiff, the *Vanguard* analysis (and the adoption of that analysis in *Wodka*) applies to Plaintiff's common law claims here. This is the case even though the common law standard is in some ways less stringent than the RICO standard, since the underlying rationale is equally applicable. *See Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 285 n.6 (2d Cir. 2006) (noting that even though RICO's proximate cause test is in some ways more stringent than that at common law, where there is no direct link between defendant's actions and plaintiff's alleged injury, a proximate cause analysis is "equally applicable to both the federal [RICO] and state causes of action"); *Laborers Local 17 Health & Benefit Fund v. Philip Morris, Inc.*, 191 F.3d 229, 238-39, 243 (2d Cir. 1999) (holding that plaintiffs' alleged injuries on RICO claims are indirect and that "analogous principles to those that doomed plaintiffs' RICO causes of action also bar plaintiffs' common law fraud and special duty actions").

As the Court recognized in *Vanguard*, Plaintiff's alleged injury was not proximately caused by Defendants' decision to invest in PartyGaming, but rather was directly caused by the government crackdown, which caused share prices to drop. *Vanguard*, 2009 WL 875220 at *3

("The direct cause of plaintiffs' injuries is therefore a 'set of actions [the government crackdown] entirely distinct from the alleged RICO violation [conducting an illegal gambling operation].'") (citation omitted). The Court explicitly held that the government's investigation of allegedly illegal gambling operations constituted an intervening act that broke the causal chain. As the Court stated, "[p]roximate causation is lacking here because the shareholders were injured not by the ownership of or investment in the illegal gambling operations, but by the reaction of the stock price to the publicity following the government's investigation of those operations." *Id.* at *3.

Just as for the RICO claims in *Vanguard* and herein, under the common law test for proximate cause, the government's actions constituted a superseding, intervening act that broke the causal chain for the proximate cause. There was no "continuous chain of causation." Therefore, even if Defendants' actions arguably could be a "but-for" cause of the alleged injury—in the sense that without the purchase of shares in PartyGaming there would be no injury to Plaintiff—such actions were not the proximate cause of Plaintiff's alleged injury.

3. Plaintiff Fails to Allege that Defendants Breached Their Duties to Shareholders (Negligence and Breach of Fiduciary Duty)

Plaintiff's claim for negligence (and breach of fiduciary duty, which is not a separate cause of action under Maryland law), must also be dismissed because Plaintiff fails to allege breach of a duty.

Under Maryland law, challenges to investment decisions by fiduciaries must be based on departures from explicit statutory standards. *See Mona v. Mona Elec. Group, Inc.*, 934 A.2d 450 (Md. Ct. Spec. App. 2007) (citing MD Corp. Code § 2-405.1(a)). The standard of care a director owes to the corporation in managing the affairs of the corporation requires that he or she act "(1) [i]n good faith; (2) [i]n a manner he or she reasonably believes to be in the best interests of the corporation; and (3) [w]ith the care that an ordinarily prudent person in a like position would use under similar circumstances." MD Corp. Code § 2-405.1(a). Under the business judgment rule, directors are presumed to have satisfied these standards. MD Corp. Code § 2-405.1(e) (codifying business judgment rule); *Mona*, 934 A.2d at 464. The burden is on the challenging party to establish facts rebutting this presumption. *Mona*, 934 A.2d at 464; *Bender v. Schwartz*, 917 A.2d 142 (Md. Ct. Spec. App. 2007).

Challenges to investment decisions are analyzed by examining what was known *at the time* about the investment, the overall portfolio, the beneficiary's purposes, and other circumstances bearing on whether the decision departed from the standard of care. *See* MD Corp. Code 2-405.1(a)(3) ("A director shall perform his duties as a director . . . [w]ith the care that an ordinarily prudent person in a like position would use *under similar circumstances*.") (emphasis added); *Gay v. State of Md. Deposit Ins. Fund Corp.*, 521 A.2d 1205, 1213 (Md. Ct. App. 1987) ("Whether a corporate fiduciary has breached the duty of loyalty to the corporation in a transaction with it is ordinarily determined as of the time of the transaction, and not by hindsight"); *see also Law v. Law*, 753 A.2d 443, 449 (Del. 2000) (noting that propriety of investment decision must be determined at the time of investment and in light of the performance of the portfolio as a whole). Pleadings that omit these allegations must be dismissed. *See Lopez v. Lopez*, 243 A.2d 588, 594 (Md. 1968) ("A beneficiary seeking to obtain relief for a breach of trust must plead and prove facts which show the existence of a trust duty, the failure of the trustee to perform it and that consequently the court should grant the requested remedy.")

The Second Amended Complaint says nothing about whether Defendants knew that the investments might prove too risky *in light of the Funds' other holdings*. It references no reason for any Defendant to have foreseen a decline in overall Fund valuation due to any potential government crackdown. Furthermore, even if a risk to the individual stock in question had been known (whether reflected in the price of the stock or not[10]), the Second Amended Complaint

[10] Plaintiff attempts to bolster its claims by including allegations of publicly available information regarding the potential illegality of online gambling websites. However, where the markets for publicly-traded stocks are "efficient," publicly available information is incorporated into stock prices. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 245-47 (1988). Thus, any known risks associated with the investment were already reflected in the stock price at the time of investment. If the crackdown and ensuing fall in gambling stock prices had been foreseeable prior to their occurrence, gambling stock prices would have already reflected them.

fails to plead that the risk was imprudent in light of the Fund's overall portfolio or inconsistent with the Fund objectives. Indeed, the Second Amended Complaint says nothing about the Fund's overall portfolio or its investment objectives.

a. Contrary to Plaintiff's Allegations, It Was Not Clear at the Time that PartyGaming was an Illegal Gambling Business or that the Government Would Crack Down on Online Gambling

Plaintiff alleges that Partygaming "was an 'illegal gambling business'" (SAC ¶ 4) and that investing in such a business was overly risky, since it was reasonably foreseeable that law enforcement would instigate enforcement efforts (SAC ¶ 7). But contrary to Plaintiff's allegations, at the time of ACMF's investment in PartyGaming, it was still very much an open question as to whether the company was an illegal gambling business at all and completely unknown that the government was going to step up its enforcement efforts and pass new legislation against internet gambling. While there were risks with PartyGaming, numerous established and well-respected investment advisors nonetheless issued statements[11] recommending the purchase of PartyGaming shares and concluding that the risk of government enforcement was not a concern that outweighed the substantial upside to the stock. For example, in June 2005, CitiGroup issued an analyst report noting the concerns about U.S. government regulation with the following recommendation:

> Despite the considerable risks and uncertainties, we find PartyGaming's business and its stock's valuation attractive and have initiated coverage with a rating of Buy/Speculative Risk (1S) and a price target of 185p, which represents a prospective total return of 40%.

See Institutional Defendants' Request for Judicial Notice ("IDRJN"), Ex. 1, at 2. Five months later, on December 8, 2005, Deutsche Bank issued a report on PartyGaming noting, "We remain confident of the investment case on PartyGaming . . . . [t]he main risk to our stance and valuation would be the successful enactment and enforcement of effective anti-online gambling legislation in the US, which we do not expect to happen . . . ." *See* IDRJN, Ex. 29, at 5.

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[11] The Institutional Defendants respectfully request that the Court take judicial notice of the additional materials they are submitting, which are not submitted for the truth of matters asserted therein, but are offered to rebut Plaintiff's broad statements that imply, if not state unequivocally, that all publicly available information was in agreement that PartyGaming's activities were illegal. That is hardly the case. As shown by the matters submitted by the Institutional Defendants for judicial notice, the vast majority of credible information that was written and publicly available called into serious question whether PartyGaming's activities (as opposed to BetOnSports' activities) violated any laws at all.

Therefore, contrary to Plaintiff's allegations, there was significant dispute at the time of the Fund's investment in PartyGaming about whether the company's business was illegal in the United States. As noted in the first Deutsche Bank "buy" recommendation cited above, at least some analysts believed that before companies in PartyGaming's business could be found guilty of anything, it would have required both (i) enactment of new laws prohibiting such activities and (ii) the government's determination to prosecute such activities.[12] Even the New York Times article that Plaintiff relies upon (SAC ¶ 83) makes it clear that the legality of PartyGaming's business was very much undecided in June 2005. IDRJN Ex. 17 at 3. (describing competing views on the legality of online gambling, comparing statements from the DOJ and the Fifth Circuit's opinion in *In re MasterCard Int'l Inc. Internet Gambling Litig.*, 313 F.3d 257 (5th Cir. 2002). These facts fly in the face of Plaintiff's allegations that Defendants breached their duties to ACMF, the Ultra Fund, and shareholders when they authorized purchase (and ownership) of PartyGaming shares.

Furthermore, Plaintiff's examples of indictments and cases purportedly showing that it was common knowledge that online gambling sites violate U.S. law are mostly not applicable to PartyGaming. For example, Plaintiff repeatedly references the Wire Act in her allegations (*see* SAC ¶¶ 71-72, 82). But in *MasterCard*, the Fifth Circuit held that the Wire Act only applies to sports gambling and does not apply to non-sports gambling (such as poker or blackjack). *Id.* at 263. Most of Plaintiff's allegations of prior prosecutions involve online sports-gambling companies and the Wire Act (*e.g.*, *US v. Cohen*, *People ex rel. Vacco v. World Interactive Gaming Corp.*, *U.S. v. Gotti*, plus the Sportingbet, Gold Medal Sports, and the BetOnSports prosecutions (*see* SAC ¶¶ 71-73, 84, 86)), and thus the applicability of such cases and prosecutions to PartyGaming was (and is) far from clear, since PartyGaming's business is not sports-based gambling (*see* Plaintiff's Request for Judicial Notice Opp. Defs' Mots. Judgment on Pleadings, Ex. 1 at 28 (PartyGaming prospectus, describing PartyGaming's business)). It is telling, therefore, that even after the BetOnSports indictment, institutional investors remained optimistic about PartyGaming's prospects. For example, on July 20, 2006, in light of the BetOnSports indictments, Deutsche Bank reiterated that PartyGaming was a "Buy."[13] (*See* IDRJN Ex. 15, at 1.)

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[12] For example, Morgan Stanley issued an analyst report on November 29, 2005 providing in-depth analysis of the regulatory regime for online gambling. IDRJN Ex. 7, at 17-19. The report acknowledges the uncertainty as to the legality of online gaming, discusses the DOJ's focus on the Wire Act, describes both direct and indirect prohibition efforts by the government, and notes the DOJ's enforcement attempts. *Id.* The report goes on to say, "[t]his all makes for fairly sobering reading. However, legal opinion is very divided on both the legality of online gambling in the US, and what can realistically be done about it." *Id.* at 18. Morgan Stanley goes on to list a number of reasons why PartyGaming can take some comfort, including a citation to the *MasterCard* case, expectation that the congressional efforts will fail, the unwillingness of the authorities to bring action against businesses with no physical presence in the US, and jurisdictional issues. *Id.* On the issue of government regulation, the report concludes, "Given the current obstacles . . . it appears likely that the status quo will persist for some time." *Id.* at 19.

b. Plaintiff Makes No Allegations Whatsoever Regarding the Investment in PartyGaming Being Imprudent in Light of the Fund's Overall Holdings and Objectives

Furthermore, to the extent that Plaintiff's allegations of breach of duty rest upon the assumption that PartyGaming was a bad investment because investment in PartyGaming was risky and had the potential for a severe loss in value, Plaintiff's claim must be denied as a matter of law. Plaintiff does not (and cannot plausibly) allege that the investment was risky in light of the Ultra Fund's overall investment portfolio, objectives and performance. *See* MD Corp. Code § 2-405.1(a)(3); *Law*, 753 A.2d at 449 (noting that propriety of investment decision must be determined at the time of investment and in light of the performance of the portfolio as a whole).

[13] In fact, Deutsche Bank's July 20, 2006 analyst report contains an extensive analysis of the potential impact of the BetOnSports indictment on PartyGaming's business. IDRJN Ex. 15, at 6. It noted that BetOnSports (1) had assets on US soil, (2) was founded and run primarily by US citizens, (3) was involved in sportsbetting, and (4) took phone bets from the US. Deutsche Bank concludes, "[n]one of these points are true for PartyGaming . . . . The indictment appears to focus on sports betting, and not casino or poker, and this is clearly significant for PartyGaming given their focus." *Id.* at 6-8.

Investors in mutual funds invest in such funds seeking above-average returns on their investments in line with the objectives of the particular fund. With most investments, the potential for an above-average return comes with the risk of loss due to unforeseen occurrences (which are therefore not factored into the market price at the time of investment). Holding directors, officers and advisors liable for a loss that results from a risky investment would work directly against shareholders' interests, since it would discourage any investments that have the potential for a market-beating return (*i.e.*, a higher net present value). As former Chancellor Allen wrote,

> If, however, corporate directors were to be found liable for a corporate loss from a risky project on the ground that the investment was too risky . . . . their liability would be joint and several for the whole loss. . . . Given the scale of operation of modern public corporations, this stupefying disjunction between risk and reward for corporate directors threatens undesirable effects. Given this disjunction, only a very small probability of director liability based on 'negligence' . . . could induce a board to avoid authorizing risky investment projects to any extent!

Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996). Most shareholders expect officers and directors to seek the highest net present value investments, and the risk posed by investments with higher potentials for return can—and, depending on the investor's or fund's objectives, should—be properly handled through diversification. As stated by the Second Circuit in *Joy v. North*, 692 F.2d 880, 886 (2d. Cir. 1982),

> because potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions. Some opportunities offer great profits at the risk of very substantial losses, while the alternatives offer less risk of loss but also less potential profit. Shareholders can reduce the volatility of risk by diversifying their holdings. In the case of the diversified shareholder, the seemingly more risky alternatives may well be the best choice since great losses in some stocks will over time be offset by even greater gains in others. Given mutual funds and similar forms of diversified investment, courts need not bend over backwards to give special protection to shareholders who refuse to reduce the volatility of risk by not diversifying. A rule which penalizes the choice of seemingly riskier alternatives thus may not be in the interest of shareholders generally.

Thus, an investment is not imprudent simply because it is risky, and officers and directors should not be held liable for such investments without more. Furthermore, as the Second Circuit recognized, one of the reasons investors choose mutual funds is because mutual funds offer an easy way to obtain the benefits of high-reward investments that carry high risk while remaining diversified, thus lowering overall risk. In other words, a mutual fund's risky stock purchase is not a reason to hold the officers and directors liable should such purchase turn out poorly, so long as the fund is diversified in line with its investment objectives. *See* MD Corp. Code § 2-405.1(a)(3); *Law*, 753 A.2d at 449.

Plaintiff's failure to allege any facts concerning the Fund's investment in PartyGaming in light of the Fund's overall holdings and its objectives is especially significant here. Under Maryland law, fiduciaries cannot be liable based on allegations made only in hindsight, or based on the alleged underperformance of one investment out of a portfolio that was in line with overall investment objectives. *See Gay*, 521 A.2d at 1213.

4. Plaintiff's Waste Allegations are Insufficient

Corporate waste takes place when "what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation has paid." *Werbowsky*, 766 A.2d at 132 (citation omitted). In other words, waste requires "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." *White v. Panic*, 783 A.2d 543, 554 (Del. 2001) (citation omitted).[14] A plaintiff must therefore plead that the Defendants "irrationally squander[ed] corporate assets—for example, where the challenged transaction served no corporate purpose or where the corporation received no consideration at all." *Id*. (quotation and citation omitted); *see also Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000) (waste is "an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration") (citation

[14] For the law of corporate waste, Maryland looks approvingly to Delaware law. *See, e.g.*, *Werbowsky*, 766 A.2d at 139.

omitted). Consequently, corporate waste claims trigger "an extreme test, very rarely satisfied by a shareholder plaintiff." *Steiner v. Meyerson*, Civ. A. No. 13139, 1995 WL 441999, at *1 (Del. Ch. July 19, 1995).

Plaintiff's waste claim fails for lack of these necessary allegations. The Second Amended Complaint does not allege that the Fund "received no consideration at all" for its investment, *White*, 783 A.2d at 554, or even that it paid too much. The Second Amended Complaint does not say how much the Fund paid for the stocks at issue, or whether those stocks ever became worthless to the Fund. Nor can Plaintiff argue that the stocks had no value at the time of the investment; they were publicly traded and presumably had the exact value that the Fund paid for them at the time of that trade. If this sort of pleading sufficed, every allegedly unprofitable expenditure—indeed any failed investment—could be challenged as a "waste" simply by the application of 20/20 hindsight.

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Conclusion

For the reasons stated above, Plaintiff has failed to state a claim, and the Institutional Defendants respectfully submit that the Second Amended Complaint should therefore be dismissed with prejudice and without leave to amend.

Dated: December 18, 2009

Respectfully submitted,

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